In the

Supreme Court of the United States

OCTOBER TERM 1978

No. 78-923

INSURANCE COMPANY OF NORTH AMERICA,

Petitioner,

v.

INDEX FUND, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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TABLE OF CONTENTS

Table of Authorities

Cases:

Statutes and Rules:

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To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, Insurance Company of North America (INA), prays that a Writ of Certiorari issue to review the decision of the United States Court of Appeals for the Second Circuit entered in this cause.

Opinions Below

Petitioner seeks review of the opinion rendered in *Index Fund, Inc.* v. *Insurance Company of North America,* 77-7600 (decided August 1, 1978) (2nd Circuit, 1978) *infra* Appendix (A 1). The opinions of United States District Judge Charles H. Tenney denying motions for summary judgment and granting INA's motion for judgment notwithstanding the verdict, neither of which are officially reported, are also set forth in the Appendix hereto (A 17, 29).

Opinions Below

The opinion and judgment sought to be reviewed are dated August 1, 1978. Judgment was entered on August 1, 1978. A petition for rehearing was denied on September 14, 1978 (A 33).

Jurisdiction

District Court jurisdiction was founded upon Section 44 of the Investment Company Act of 1940, 15 U.S.C. § 80a-43, and diversity of citizenship, 28 U.S.C. § 132.

The statutory provisions which confer jurisdiction upon this Court to review the judgment in question are 28 U.S.C. § 1254(1) and 28 U.S.C. § 210(c).

Questions Presented

1. Do Section 17(g) of the Investment Company Act of 1940 and Securities and Exchange Commission Rule 17g-1 preclude the insurer from denying liability on a bond which excludes coverage for the type of loss claimed by the insured?

2. Where a Circuit Court of Appeals claims to be applying state law may it ignore controlling cases decided by the highest court of said state?

Statute Involved

The statute involved is The Investment Company Act of 1940, 15 U.S.C. 80a, *et seq*, specifically 15 U.S.C. 80a-17(g) and 15 U.S.C. 80a-35. Securities and Exchange Commission Rule 17g-1, 17 C.F.R. § 270.17g-1, is also pertinent (A 41, 42).

Statement

Petitioner, INA, was sued herein on a policy of insurance known as a Brokers Blanket Bond, Standard Form 14, issued to Index Fund Inc., an open-end investment company, i.e., a mutual fund, organized pursuant to the Investment Company Act of 1940. Index Fund claimed to have sustained a loss by reason of the dishonest acts of an employee, its former president, Robert Hagopian. INA took the position that the claimed loss fell within an exclusion clause of the Bond and was, therefore, not covered.

The Bond in Suit:

From July 25, 1968 to June 30, 1973 Index Fund was a named insured on three Brokers Blanket Bonds, Standard Form 14, issued by INA.

The details as to the effective dates and the amounts of the three Bonds are as follows:

Bond No.	*Broker*	*Penal Amount*	*Effective Date*	*Cancellation Date*
S 627001	Alexander & Alexander Inc.	$100,000	7/25/68	6/ 1/70
S 626228	Mark F. Hopkins & Co.	100,000	1/ 1/70	1/ 1/71
S 624611	Bleichroeder-Bing, Inc.	100,000	6/30/71	6/30/73

Essentially the bonds are identical and we will hereinafter refer to them as the "Bond." The Bond provides in pertinent part:

"The losses covered by this bond are as follows:

DISHONESTY

(A) Loss through any dishonest or fraudulent act of any of the Employees, committed directly or by

collusion with others, including loss of Property through any such act of any of the Employees."

* * *

"The foregoing agreement is subject to the following conditions and limitations:
Section 1. This bond does not cover:

* * *

(e) (1) Any loss resulting directly or indirectly from trading, including all transactions involving the purchase, sale or exchange of securities, with or without the knowledge of the insured, in the name of the insured or otherwise, whether or not represented by any indebtedness or balance shown to be due the insured on any customer's account, actual or fictitious, and notwithstanding any act or omission on the part of any Employee in connection with any account relating to such trading, indebtedness, or balance."

If plaintiff had paid an additional premium the "trading exclusion" would have read as follows:

"Any loss resulting directly or indirectly from trading, including all transactions involving the purchase, sale or exchange of securities, with or without the knowledge of the Insured, in the name of the Insured or otherwise, whether or not represented by any indebtedness or balance shown to be due the Insured on any customer's account, actual or fictitious, except when covered under Insuring Clause (A), (D) or (E)."

The Facts:

At all material times Index Fund was an open end investment company, i.e. a mutual fund, organized pursuant to the Investment Company Act of 1940.

On November 4, 1969 Index Fund's board of directors elected one Robert R. Hagopian as president. As president, Hagopian's duties included the purchase, sale, delivery and receipt of stocks, bonds and other securities, cash and other forms of investments on behalf of Index Fund.

On many occasions while he was president, Hagopian bought and sold securities for Index Fund. No claim was made that any dishonesty was involved in any of these transactions, except for eight which commenced on June 16, 1970.

Index Fund claims that on or about June 1, 1970 Hagopian entered into a conspiracy with persons who were not employees of Index Fund to purchase securities at inflated prices; that from June 6, 1970 to August 6, 1970 in furtherance of said conspiracy Hagopian caused Index Fund to purchase shares of stock of eight corporations at an aggregate purchase price of $1,034,840; that the securities were subsequently sold by Index Fund at prices aggregating $301,594 with a resulting loss to Index Fund of $732,246.

The transactions were as follows:

Security	*No. Units*	*Trade Date*	*Purchase Price*	*Date of Sale*	*Proceeds*
Health, Evaluations, Inc., Common Stock	9,000 shs.	6/16/70	$ 145,080	12/13/72	$ 1.00
Devon International, Ltd. Common Stock	15,000 shs.	6/16/70	136,275	9/23–10/12/70	33,098.00
Regency for Men, Ltd. Common Stock	35,000 shs.	6/16/70	142,100	4/ 7/71	74,175.00
Nationwide Marketing Assc., Common Stock	35,000 shs.	6/16/70	142,100	9/17/70	30,231.00
Hair Extension Center, Inc. Warrants	20,000 wts.	6/17/70	121,460	12/13/72	1.00
Haywood Mf'g. Inc. Common Stock	15,000 shs.	7/ 7/70	128,955	9/24–11/13/70	49,827.00
Summit Group Common Stock & Warrants	4,800 units	7/23/70	120,000	9/28–11/30/70	77,563.00
Computerized Knitwear, Inc.	7,000 shs.	8/ 6/70	98,870	8/31–12/11/70	36,698.00
			$1,034,840		$301,594.00

On January 22, 1978 Hagopian pled guilty to a count in an indictment in the United States District Court, Southern District of New York, which charged that on August 6, 1970 he had "embezzled monies, funds, securities, credits, property and assets" of Index Fund in the approximate amount of $98,870.

Index Fund thereafter filed with INA an itemized proof of claim alleging that it had sustained a loss in excess of $733,000 by reason of the aforementioned purchases of eight issues of stock.

On May 8, 1973 INA sent a letter to Index Fund denying liability on the ground, among others, that plaintiff's loss fell within the "trading exclusion" of the bond.

The Proceedings Below:

This action was commenced on or about May 30, 1973. The complaint claimed federal jurisdiction by reason of Section 44 of the Investment Company Act of 1940 (Act).

On or about September 4, 1974 Index Fund moved for summary judgment. INA opposed the motion and cross moved for summary judgment on the ground that the loss sustained by Index Fund came within the "trading exclusion" of the Bond and to dismiss the complaint on the ground that the Court did not have jurisdiction under the Act and diversity was not pleaded in the complaint.

On January 15, 1975 United States District Judge Charles H. Tenney filed an order dismissing plaintiff's complaint with leave to replead within 20 days of the filing of the order. The Court did not reach INA's cross motion for summary judgment.

Index Fund served an amended complaint within the allotted time and defendant duly served and filed its answer thereto.

On or about September 3, 1975 INA moved for summary judgment on the ground that plaintiff's loss, if any, came within the "trading exclusion" of the Bond. Index Fund cross-moved for summary judgment.

On June 18, 1975 Judge Tenney filed an order denying both the motion and the cross motion. As to INA's motion Judge Tenney found that there were issues of fact as to the meaning of "trading" in a brokers bond when issued to an investment comapny, as to the circumstances surrounding the issuance of the bond, and as to the causative acts which occasioned the loss to Index Fund.

The case came on for trial before Judge Tenney and a jury on June 21, 1977. On June 23, 1977 the jury returned a verdict in favor of Index Fund for $98,870.

INA moved for judgment notwithstanding the verdict and for a new trial. On October 18, 1977 Judge Tenney filed an order granting INA's motion for judgment notwithstanding the verdict and conditionally granting the motion for a new trial in the event that the judgment was later vacated or reversed unless plaintiff accepted a remittitur of $36,698 (A 17).

In granting INA's motion the District Court found that the evidence at trial showed that the term "trading" has no different meaning in a Brokers Blanket Bond, Form 14, when issued to an investment company than in any other use of the bond; that there was no evidence at trial that the bond was issued to Index Fund under circumstances which would indicate that the bond's trading exclusion should be disregarded because of any inconsistency with the requirements of 15 U.S.C. § 80a-17(g) and 17 C.F.R. § 270.17g-1; and that the evidence presented at trial, when examined in the light of the Court's findings as to the law, is such that there can be only one reasonable conclusion: the losses suffered by Index Fund are specifically excluded from coverage of the bond.

Index Fund appealed to the Circuit Court of Appeals for the Second Circuit. The Securities and Exchange Com-

mission and the Investment Company Institute filed *amici curiae* briefs supporting Index Fund's position.

On August 1, 1978 the Second Circuit in a 2-1 decision reversed the judgment n.o.v. and affirmed the order granting a new trial *nisi* (A 1).

The majority held that the Bond in suit was a "statutory bond" and must be read in conjunction with the statutory requirements pursuant to which it was issued; that in requiring a bond to provide coverage against losses from "larceny and embezzlement" by an officer of a registered investment company, Congress intended such bonds to cover the kind of dishonest activity in which Index Fund's employee engaged and, thus, INA is liable on the Bond to Index Fund for those losses it suffered from the dishonest acts of Hagopian.

The majority also held that where the obligee of a Brokers Blanket Bond is an investment company rather than a stockbroker, fraudulent purchase of securities for the company by a covered employee at a manipulated price may well be considered outside the contemplated meaning of "trading."

The Second Circuit affirmed the Trial Court's order granting a new trial unless Index Fund accepted a remittitur of $36,698. Index Fund has consented to a reduction of the verdict in the amount of said remittitur.

Judge Thomas J. Meskill dissented, saying that the loss sustained by Index Fund was clearly within the "trading exclusion" of INA's bond; that Index Fund could have purchased a more expensive bond which would have protected it from the type of loss involved here, but it chose not to do so; and that the majority's use of the provisions of the Investment Company Act to relieve Index Fund of the consequences of its choice is "unprecedented and unwarranted."

Reason for Granting the Writ

This appeal brings to this Court for resolution: a novel issue as to the rights of the insured and the insurer on a Bond filed with the Securities and Exchange Commission pursuant to the Investment Company Act of 1940; an erroneous application of state law by the Circuit Court of Appeals.

ARGUMENT

I

The Court Below Disregarded the Intentions of the Parties to the Insurance Contract.

It was established at the trial that on three occasions Index Fund, by three different brokers, requested and obtained bonds from INA for filing with the Securities and Exchange Commission pursuant to Commission Rule 17g-1, 17 C.F.R. § 270.17g-1.

It was further established that if Index Fund had requested coverage for losses occasioned by dishonest trading by employees and paid an additional premium therefor, such coverage would have been provided under the Bond. There was no evidence that Index Fund had requested the additional coverage (A 24).

In other words there were two forms of Bond available to Index Fund. Both forms provided coverage for losses caused by dishonest or fraudulent acts of employees. One form, however, excluded any "loss resulting directly or indirectly from trading, including all transactions involving the purchase, sale or exchange of securities, with or without the knowledge of the insured, in the name of the insured or otherwise. . . ." Index Fund on three occasions elected to purchase this form of bond rather than the more expensive form which would have provided coverage for losses due to dishonest purchases or sales of stock by employees.

The majority below, citing *American Casualty Co. of Reading* v. *Irwin,* 426 F.2d 647 (5th Cir. 1970), held that the Bond in suit is a statutory bond and, thus, consideration must be given to the language of the statute and the purpose for which the bond is given. The majority found that in requiring a bond to provide coverage against "larceny and embezzlement" by an officer of a registered investment company, Congress intended such bonds to cover the kind of dishonest and fraudulent activity in which Hagopian engaged, reversed the District Court and held INA liable for Hagopian's dishonest and fraudulent activities (A 9).

The *Irwin* case, *supra,* held that generally the provisions of the statute will be read into a statutory bond and that any provisions therein which do not comply with the requirements may be eliminated as surplusage and denied legal effect. While *Irwin* may state the general rule, we have found no case (other than the decision below) which applies that rule where the insured had a choice of available coverage. This is a novel issue which this Court should decide.

We submit that Index Fund exercised a choice of the coverage it wished to purchase and there is no valid reason for rewriting the Bond to provide the precise coverage which Index Fund declined to purchase.

The intent of the parties to the contract should control. Index Fund elected to purchase a bond wherein losses directly or indirectly caused by the dishonest purchase, sale or exchange of a security are excluded from the coverage.

Moreover, in the *Irwin* case the Fifth Circuit relied upon and followed *Fort Smith Structural Steel Co.* v. *Western Surety Co.,* 247 F.Supp. 674 (W.D. Ark., 1965). The court in the *Fort Smith* case was applying Arkansas law and thus followed *Crawford* v. *Ozark Insurance Co.,* 97 Ark. 549, 553; 134 S.W. 951, 952 (1911) where the state court said:

> "We must presume that it was the intention of the bondsmen to execute the bond in compliance with the requirements of the statute; and, unless it would be doing violence to the language of the bond itself, it is our duty to so hold."

In the instant case the majority in the Second Circuit certainly did violence to the bond language when they read the exclusion out of the Bond.

In his dissent, Judge Meskill argued that the majority had given "undue, in fact, controlling weight to the statute in circumstances involving statutorily required bonds, even to the exclusion of the obvious intent and understanding of the parties to the contract. No court should go that far" (A 15).

If the majority is correct, neither insured nor insurer have any say in the wording of any bond required by a local, state or federal statute even though the statute is silent as to the terms and conditions of the bond called for. It will be difficult for insurers to write bonds under these conditions. If insurers should withdraw from the market, hardship might result for persons who are required by the statute to post bonds.

While there might be some justification for conforming the bond to the statute when the insured has no choice of the available coverage, there is no reason why the bond should be gratuitously enlarged when the insured has obtained that which he has selected from a variety available to him.

II

The Bond wording is clear.

The Bond provides that there is no coverage for any loss resulting directly or indirectly from trading, including all transactions involving the purchase, sale or exchange of securities.

At trial three witnesses testified that the terms of the Bond and the meaning of said terms are no different when the Bond is purchased by an investment company than when purchased by a stockbroker (A 20, 21). Index Fund offered no testimony to the contrary. Nor did the majority in the Second Circuit cite any evidence or give any reason for holding that "Where, as here, the obligee is a regulated investment company rather than a broker, fraudulent purchase of securities for the company by the covered employee at a manipulated price may well be considered outside the contemplated meaning of 'trading'" (A 8).

From the outset of the litigation Index Fund has taken the position that its loss is the difference between what the eight issues of stock were purchased for and what they were later sold for, see p. 5, *supra*. How can it be gainsaid that these are "transactions involving the purchase, sale or exchange of securities"? Whether the obligee is an investment company or a broker the terms are the same and can have only one reasonable construction.

In *First Nat. Bank of East Islip* v. *National Sur. Co.*, 228 N.Y. 469, the New York State Court of Appeals stated at p. 472:

> "We are not to interpret where there is not reasonable doubt concerning what the parties really agreed upon."

In making its determination as to the meaning of "trading" the majority purported to be following the law of the State of New York. In so doing, however, the court ignored the only two cases in which the highest court of New York State passed upon the precise language of the exclusion and found the wording to be unambiguous, *Kean* v. *Maryland Casualty*, 221 App. Div. 184, *aff'd* 248 N.Y. 534 (1928) and *Condon* v. *National Surety Corp.*, 22 A.D.2d 305, 254 N.Y.S.2d 620, *aff'd* 16 N.Y.2d 725, 262 N.Y.S.2d 499, 209 N.E.2d 819.

The vast majority of courts, federal and state, which have had the exclusion before them have held that the language is to be given its ordinary meaning, i.e. the buying and selling of securities. No court in the past fifty years, other than the court below, has found that the language is subject to more than one meaning.

As Judge Meskill observed in his dissent, the court should not strain to construe the provision against INA.

III

The decision below conflicts with a decision of the United States District Court, Northern District of California which is on appeal to the Ninth Circuit.

Research Equity Fund v. *The Insurance Company of North America* (C-74-1174), a case which has several factual similarities to the instant matter was decided on December 16, 1976 by United States District Judge Albert C. Wollenberg in the United States District Court for the Northen District of California. The case has been briefed and was argued in the United States Court of Appeals for the Ninth Circuit December 4, 1978.

Judge Wollenberg's opinion was followed by Judge Tenney in deciding the instant matter in the District Court (A 23).

Judge Wollenberg's conclusions of law are appended hereto (A 47). One of said conclusions is substantially as follows (A 51).

> "Despite the statutory bond situation . . . considering the trading loss exclusion to be inapplicable to the claimed losses would be 'necessarily and absolutely inconsistent with the unequivocal intent of the parties as disclosed by the express terms of the bond itself.' *Milliron* v. *Dittman*, 180 Cal. 443, 446 (1919)."

The wording of the bonds in the *Research Equity* case and in the instant case are identical. Research Equity Fund, Inc. is an investment company, not a broker. There was no finding that the wording of the bond in *Research Equity* was subject to more than one reasonable construction.

The two cases are factually very close and of the five judges who have had the issues before them, Circuit Judge Meskill and District Judges Tenney and Wollenberg have found for the insurer while Circuit Judges Kaufman and Smith have found for the insured investment company.

If Judge Wollenberg is affirmed there will be a conflict in the Circuits.

The importance of the issues was illustrated by the filing of briefs, *amici curiae*, by the Securities and Exchange Commission and the Investment Company Institute.

CONCLUSION

For the foregoing reasons this Petition for a Writ of Certiorari should be granted.

Dated: New York, New York, December 1, 1978.

Respectfully submitted,

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APPENDIX

OPINION OF THE COURT OF APPEALS

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 771—September Term, 1977.

(Argued March 23, 1978 Decided August 1, 1978.)

Docket No. 77-7600

INDEX FUND, INC.,

Plaintiff-Appellant,

v.

INSURANCE COMPANY OF NORTH AMERICA,

Defendant-Appellee.

Before:

KAUFMAN, *Chief Judge,*
SMITH and MESKILL, *Circuit Judges.*

Appeal in action on fidelity bond from judgment for defendant notwithstanding the verdict in the United States District Court for the Southern District of New York, Charles H. Tenney, *Judge.*

Judgment n.o.v. reversed, order granting new trial *nisi* affirmed.

CHARLES E. MCGUINNESS, New York, N.Y., *for Appellant.*

WILLIAM P. SULLIVAN, JR. (Bigham, Englar, Jones & Houston, New York, N.Y.), *for Appellee.*

JACOB H. STILLMAN, Principal Assistant General Counsel, Securities and Exchange Commission, Washington, D.C. (Harvey L. Pitt, General Counsel, Sue E. Auerbach and John M. Metzger, Attorneys, Securities and Exchange Commission, of counsel), *for Securities and Exchange Commission, Amicus Curiae.*

SULLIVAN & CROMWELL, New York, N.Y., Marvin Schwartz, Stephen K. West and Ann T. Bailen, on the brief, *for Investment Company Institute, Amicus Curiae.*

SMITH, *Circuit Judge:*

This is an appeal in an action on a fidelity bond from a judgment of the United States District Court for the Southern District of New York, Charles H. Tenney, *Judge,* entered for the defendant bonding company notwithstanding the verdict and ordering a remittitur or a new trial in the event this judgment is vacated or reversed. We reverse the judgment *n.o.v.* and affirm the order granting a new trial *nisi.*

Index Fund, Inc. ("Index Fund") is a Massachusetts corporation organized pursuant to the Investment Company Act of 1940 (the "Act"), 15 U.S.C. § 80a-1 *et seq.* Rule 17g-1 of the Securities and Exchange Commission (the "Rule"), 17 C.F.R. § 270.17g-1, promulgated under § 17(g) of the Act, 15 U.S.C. § 80a-17(g), required Index Fund to obtain a fidelity bond against larceny and embezzlement covering those of its officers who had access to its funds or securities or the authority to draw such funds or dispose of such securities. The Rule also required that the bond "shall provide that it shall not be cancelled, ter-

minated or modified except after written notice shall have been given by the acting party to the affected party and to the Commission not less than 30 days prior to the effective date of cancellation, termination, or modification." 17 C.F.R. § 270.17g-1(a).

Over a period of years Index Fund purchased three bonds from Insurance Company of North America ("I.N.A."), a Pennsylvania corporation. The third of these bonds, effective from July 30, 1971 to June 31, 1973, was procured through Bleichroeder Bing & Co., Inc., 127 John Street, New York, New York.[1] Attached to the first two bonds were riders containing the so-called "cancellation clause." The rider accompanying the second of these bonds bore the legend: "For use with brokers' blanket bonds, Forms 14 Basic and 14 Broad, when issued to registered investment companies. To comply with the rules of the Securities and Exchange Commission."

Each of the bonds issued by I.N.A. to Index Fund contained the provisions set out in the margin.[2] Losses up to

1 The "principal address" of Index Fund as stated on this bond was 20 Exchange Place, New York, New York. The manager of I.N.A.'s Bond Burglary Department testified at trial that this bond was "written by I.N.A., the New York office of North America" and a senior underwriter of I.N.A.'s Fidelity Burglary Department also testified that this bond was written out of I.N.A.'s New York Office.

2 The losses covered by this bond are as follows:

DISHONESTY

(A) Loss through any dishonest or fraudulent act of any of the Employees, committed anywhere and whether committed directly or by collusion with others, including loss of Property through any such act of any of the Employees.

. . . .

The foregoing agreement is subject to the following conditions and limitations:

Section 1. This bond does not cover:

. . . .

(e)(1) Any loss resulting directly or indirectly from trading, including all transactions involving the purchase, sale or ex-

a monetary limit of $100,000 were covered by each of the bonds.

On November 4, 1969 Robert R. Hagopian was elected president of Index Fund. Hagopian's duties as president included the purchase, sale, delivery and receipt of stocks, bonds and other securities, cash and other forms of investment in the name and on behalf of Index Fund. While he was president, Hagopian bought and sold securities on behalf of Index Fund on many occasions.

Plaintiff's case is based on a claim that on about June 1, 1970, Hagopian was bribed by and entered into a conspiracy with certain persons who were not employees of Index Fund to purchase certain securities at prices which Hagopian knew to be manipulated. From June 16, 1970 to August 6, 1970 Hagopian purchased for Index Fund at inflated prices the securities of various companies, including those of a corporation named Computerized Knitwear, for a total expenditure of funds in the amount of $1,034,840. From September 17, 1970 to December 13, 1972 these securities were sold, after their prices had fallen, for $301,594.

On August 7, 1972 an indictment was returned in the United States District Court for the Southern District of New York against Hagopian and four co-defendants. Named as a co-conspirator but not as a co-defendant was Akiyoshi Yamada, an investment advisor whose activities in the securities markets are not unknown to this court.[3] Count 19 of the indictment charged that Hagopian and one Peter Galanis "unlawfully, wilfully and knowingly,

change of securities, with or without the knowledge of the Insured, in the name of the Insured or otherwise, whether or not represented by any indebtedness or balance shown to be due the Insured on any customer's account, actual or fictitious, and notwithstanding any act or omission on the part of any Employee in connection with any account relating to such trading, indebtedness, or balance.

3 See *Rolf* v. *Blyth, Eastman Dillon*, 570 F.2d 38 (2d Cir. 1978).

did abstract, convert to their own use, and embezzle monies, funds, securities, credits, property, and assets of . . . Index Fund . . . [on] 8/6/70 . . . [in the amount of] $98,870." On January 22, 1973 Hagopian entered a plea of guilty to Count 19 of the indictment.[4]

On the basis of information in the indictment and in a bill of particulars which followed it, Index Fund later reconstructed the securities transactions mentioned above and filed proof of claim for loss on the bonds. I.N.A. denied liability and this action followed. There was evidence from records of the custodian bank of the purchase of Computerized Knitwear shares for $98,870 and the sale of the same shares for $36,698.

The trial judge charged the jury that to return a verdict for Index Fund, it must find by a preponderance of the evidence that Index Fund suffered a loss, that the loss was caused by Hagopian's acts, and that such acts were dishonest and fraudulent. He further instructed the jury that if it found the fund suffered such a loss that it must then consider "whether the losses fell within a specific exclusion from liability contained in the bond." Section 1(e)(1) was then read to the jury. Finally, the jury was told that if it found that the losses were caused by fraudulent or dishonest acts by Hagopian which did not result

4 Hagopian at his sentencing testified as follows:

The Court: Now, as to Count 19, tell me what you did.

A. In Count 19?

Q. That's the $98,878 we are talking about, since 1970.

A. Yes, sir. That was with respect to the Index Fund, of which I was an executive officer, and I caused securities to be bought for greater than its [sic] actual value at the time, which caused a loss to the mutual fund.

Q. Did you do that intentionally?

A. I did, sir.

Q. Did you know when you did this that this was a breach of your fiduciary duty?

A. Yes, sir.

[Record on Appeal, Plaintiff's Exhibit 45]

from trading, that the jury must determine the amount of Index Fund's loss. During its deliberations the jury requested and received a copy of the indictment to which Hagopian had pled guilty. The jury returned a verdict in favor of Index Fund in the amount of $98,870.

After trial, I.N.A. moved for a judgment notwithstanding the verdict. The court granted this motion on the ground that Index Fund's claim was excluded from coverage because the transactions at issue came within the meaning of "trading" in § 1(e)(1). I.N.A. also moved for a new trial and the court, pursuant to Fed. R. Civ. P. 50(c)(1), decreed that if its judgment was vacated or reversed on appeal that this motion would be granted unless Index Fund agreed to accept a remittitur in the amount of $36,698.[5]

Index Fund appealed and we assumed jurisdiction under 28 U.S.C. § 1291. Briefs were submitted by the Investment Company Institute and by the Securities and Exchange Commission as *amici curiae.*

Index Fund argues on appeal that its losses are not excluded from coverage by virtue of § 1(e)(1) because the transactions were not "trading" within the meaning of that provision. Second, Index Fund argues that even if the transactions were "trading," the provision should be given no legal effect since recovery was sought under a statutory bond for losses as to which the statute requires coverage. Third, it argues that the amount of the award is not excessive, not against the evidence, and not speculative and should therefore be reinstated on remand.[6]

5 The trial judge reasoned with respect to the remittitur that "the only loss proved by plaintiff was the $62,172 from the Computerized Knitwear transaction, and any verdict other than that would have been excessive, speculative and contrary to the evidence."

6 I.N.A. argues that the court below was correct in setting aside the verdict because Index Fund's losses resulted from "trading" and that the bond should not be construed so as to read the exclusion out of the bond for to do so would do violence to the language of the bond and disregard entirely the intent of the parties to it. I.N.A. does not address the matter of proof of Index Fund's losses. The Insurance Company Institute and the Securities and Exchange Commission assert that the losses allegedly sustained by Index Fund were of the kind against which the Act and the Rule were intended to protect.

Since this action under the complaint as amended is based on diversity, we apply the substantive law, which includes the conflict of law rules, of the State of New York. See *Klaxon Co.* v. *Stentor Electric Mfg. Co.,* 313 U.S. 487 (1941); *Erie R.R.* v. *Tompkins,* 304 U.S. 64 (1938); *Sutro Bros. & Co.* v. *Indemnity Insurance Co. of North America,* 386 F.2d 798, 801 (2d Cir. 1967); 1A, Part 2, *Moore's Federal Practice* ¶0.311.

Under New York conflict of law rules, courts when construing the meaning of words in or the validity of a provision in a contract, apply the local law of that state which has the greatest interest in or most significant relationship to the transaction and the parties. See *Intercontinental Planning, Ltd.* v. *Daystrom, Inc.,* 24 N.Y.2d 372, 382-85, 248 N.E.2d 576, 580-82, 300 N.Y.S.2d 817, 825-28 (1969); *Auten* v. *Auten,* 308 N.Y. 155, 124 N.E.2d 99 (1954). In the case before us the state with the most significant contacts and greatest interest is the State of New York.

Where the words in a provision of a fidelity bond are subject to more than one reasonable construction, the courts applying New York law construe such words most favorably to the insured and most strictly against the insurer; see *Cohon* v. *U.S. Fidelity & Guaranty Co.,* 172 Misc. 51, 13 N.Y.S.2d 976, *aff'd,* 19 N.Y.S.2d 144 (1940); *McClare* v. *Massachusetts Bonding & Ins. Co.,* 366 N.Y. 371, 377, 195 N.E. 15, 17 (1935); *Whitestone* v. *Title Guaranty & Surety Co.,* 72 Misc. 498, 131 N.Y.S. 390, 393, *aff'd,*

132 N.Y.S. 1149, *aff'd,* 209 N.Y. 512 (1913), especially where the doubt is found in an exclusionary provision, see *Thomas J. Lipton, Inc.* v. *Liberty Mutual Ins. Co.,* 34 N.Y.2d 356, 361, 314 N.E.2d 37, 39, 357 N.Y.S.2d 705, 708 (1974); *Sincoff* v. *Liberty Mutual Fire Ins. Co.,* 11 N.Y.2d 386, 391, 183 N.E.2d 899, 230 N.Y.S.2d 13, 15 (1962). Accordingly, if fairly possible, § 1(e)(1) must be construed against I.N.A. and in favor of Index Fund so as not to exclude Index Fund's losses from coverage. Where, as here, the obligee is a regulated investment company, rather than a broker, fraudulent purchase of securities for the company by the covered employee at a manipulated price may well be considered outside the contemplated meaning of "trading."

Moreover, even if "trading" were ordinarily read to include activities such as Hagopian's, there is another factor present here. The bond at issue is a so-called "statutory bond." Under New York law it must be read in conjunction with the statutory requirements pursuant to which it was issued where, as here, the issuer knew or ought to have known of the statutory provisions. *People* v. *Metropolitan Surety Co.,* 211 N.Y. 107, 113, 105 N.E. 99, 100-101 (1914); *People* v. *Condor of Americas, Inc.,* 43 Misc. 2d 899, 252 N.Y.S.2d 619, 622 (Sup. Ct. Sp. T. N.Y. Cty. I 1964), *aff'd,* 258 N.Y.S.2d 338 (Sup. Ct. App. Div. 1st Dept. 1965); *Lamb* v. *U.S. Fidelity & Guaranty Co.,* 162 N.Y.S. 138, 139-40 (Sup. Ct. Trial T. Kgs. Cty. 1916); see *Eckstein* v. *Massachusetts Bonding & Ins. Co.,* 281 N.Y. 435, 438-39, 24 N.E.2d 114 (1939). Consideration must be given to the language of the statute and the purpose for which the bond is given. *American Casualty Co. of Reading, Penn.* v. *Irwin,* 426 F.2d 647 (5th Cir. 1970). A principal objective of the Act was "to mitigate and, in so far as is feasible, to eliminate" conditions described

therein, such as "when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers . . . thereof . . . rather than in the interest of . . . such companies' security holders." 15 U.S.C. § 80a-1.[7]

We have no doubt that in requiring a bond to provide coverage against losses from "larceny and embezzlement" by an officer of a registered investment company Congress intended such bonds to cover the kind of dishonest and fraudulent activity in which Hagopian engaged. See generally *Brown* v. *Bullock,* 294 F.2d 415, 418-19 (2d Cir. 1961). Consequently, we conclude that I.N.A. is liable on the bond to Index Fund for those losses it suffered from the dishonest and fraudulent activities of Hagopian.

There remains the question of the order for a new trial *nisi.*

Whether the district court abused its discretion in ordering a new trial on the basis of excessive damages is usually considered a matter of federal law. 11 Wright & Miller, *Federal Practice and Procedure:* Civil § 2802 (1973). See *Galard* v. *Johnson,* 504 F.2d 1198, 1200 n. 1 (7th Cir. 1974). In this circuit it is an open question whether the test for sufficiency of evidence in a diversity case is one of federal or state law. *Mehra* v. *Bentz,* 529 F.2d 1137, 1139 n. 2a

7 In hearings before the passage of the Act, the Chief Counsel of the Securities and Exchange Commission, presenting a lengthy report on investment trust and investment company abuses, commented that "[s]ubordination of the interests of the security holders to those of . . . management take many forms. I am not speaking merely of the instances of outright embezzlement. I am referring to the unloading of worthless securities . . . upon the companies." Hearings on S. 3580 before a Subcommittee of the Senate Committee on Banking and Currency, 76th Cong., 3d Sess. at 37 (1940). "[L]ooters" of investment trusts engaged in such activities had been indicted for larceny. *Id.,* at 64. The Chief Counsel further testified that §17(g) would help shareholders in investment companies recover their companies' losses resulting from such fraudulent conduct. *Id.,* 53, 61, 73, 80, 264-65.

(2d Cir. 1975), *cert. denied,* 426 U.S. 922 (1976). The trial judge granted I.N.A.'s motion for a new trial because he found the evidence legally insufficient to support the amount of the jury's award. The Tenth Circuit has held that under federal law, "to be insufficient to support a verdict, the evidence must all be one way from which only one reasonable inference can be drawn." *United States* v. *Hess,* 341 F.2d 444, 448 (10th Cir. 1965). New York's conflict of law rules would direct us to apply New York's local law, *Anderson* v. *Material Co-ordinating Agency,* 63 N.Y.S.2d 324, 325 (Sup. Ct. 1946), pursuant to which a jury verdict should not be set aside unless it is clear from the record that the jury could not have reached its conclusion on any fair interpretation of the evidence. *McMurren* v. *Carter,* 46 App. Div. 2d 682, 360 N.Y.S.2d 66, *aff'd* 38 N.Y.2d 742, 343 N.E.2d 760, 381 N.Y.S.2d 42 (1975); *Mallo* v. *Pembleton,* 38 App. Div. 2d 874, 329 N.Y.S.2d 154 (1972). There were losses in securities transactions involving Hagopian in excess of the bond limits of $100,000 and it may be that an inference might have been drawn by the jury that they were all results of his fraud. The inference was not compelled, however, and the precise amount found could only have had reference to one particular transaction. The only direct evidence that Index Fund's losses resulted from dishonest or fraudulent activity by Hagopian was Hagopian's testimony and his plea of guilty to Count 19 which involved only the Computerized Knitwear transaction. This evidence indicates that Index Fund proved losses resulting from Hagopian's dishonest and fraudulent activity of only $62,172, the purchase price of $98,870 less the amount realized on sale of that stock of $36,698. Thus, under either the federal or the state test for sufficiency of evidence, the trial judge cannot be said to have abused his discretion in ordering a new trial unless Index Fund accepts a remittitur of $36,698.

Where a motion for a new trial has been conditionally granted by the district court and the judgment reversed on appeal, the new trial shall proceed unless the appellate court orders otherwise. Fed. R. Civ. P. 50(c)(1). For the reasons given above, we hold that I.N.A. is liable on the bond for Index Fund's established losses resulting from Hagopian's dishonest and fraudulent acts, reverse the judgment notwithstanding the verdict, and affirm the district court's order granting a new trial unless Index Fund accepts the remittitur.

Remanded for further proceedings not inconsistent with this opinion.

MESKILL, *Circuit Judge,* dissenting:

I respectfully dissent. In my judgment, the loss suffered by Index Fund was clearly within the "trading exclusion" of the bond issued by I.N.A. Index Fund could have purchased a more expensive bond which would have protected it from the type of loss involved here, but it chose not to do so. The majority's use of the provisions of the Investment Company Act to relieve Index Fund of the consequences of its choice is unprecedented and unwarranted.

The insurance contract purchased by Index Fund is a fidelity bond labeled "Brokers' Blanket Bond, Form No. 14." This same bond is issued by I.N.A. to stockbrokers, investment banks and mutual funds. The bond provides in part as follows:

The losses covered by this bond are as follows:

DISHONESTY

(A) Loss through any dishonest or fraudulent act of any of the Employees, committed anywhere and whether committed directly or by collusion with

> others, including loss of Property through any such act of any of the Employees.
>
> . . . .
>
> The foregoing agreement is subject to the following conditions and limitations:
>
> Section 1. This bond does not cover:
>
> . . . .
>
> (e)(1) Any loss resulting directly or indirectly from trading, including all transactions involving the purchase, sale or exchange of securities, with or without the knowledge of the Insured, in the name of the Insured or otherwise, whether or not represented by any indebtedness or balance shown to be due the Insured on any customer's account, actual or fictitious, and notwithstanding any act or omission on the part of any Employee in connection with any account relating to such trading, indebtedness, or balance.

Unlike the majority, I do not believe that, at least in its application to the circumstances of this case, this provision is "subject to more than one reasonable construction." *Ante* at 4157. Nor do I believe that this Court should strain to construe the provision against I.N.A.

The bond is clear. Losses resulting from dishonest or fraudulent acts of employees are covered unless they result *"directly or indirectly* from trading, including *all* transactions *involving* the purchase, sale or exchange of securities." (emphasis added). The district court was no doubt correct in its determination that Hagopian's actions were dishonest and that those actions occasioned the loss. It is equally obvious to me that the loss resulted "directly

or indirectly" from "trading," *i.e.,* from a transaction "involving the purchase, sale or exchange of securities."

Mr. George F. Hoffman, president of Index Fund, testified that Hagopian had arranged for Index Fund to acquire eight different securities, the aggregate "purchase price" or "cost" of which was over a million dollars. He also testified that the "sale and disposition" of those securities resulted in "aggregate proceeds" amounting to a little over $300,000. The loss, then, was over $700,000. On cross-examination, the following colloquy took place:

> Q. And the loss is computed as total loss, the difference between the total price paid for the stock when you bought it and the total price that you got for the stock when you sold it, is that correct?
>
> A. That's correct.

In other words, the loss resulted from "trading" as that term is understood in an entirely ordinary sense—the buying and selling of securities. The fact that the "trading exclusion" is phrased in expansive terms serves only to strengthen my belief that the loss here resulted from precisely the type of activity that the parties intended and understood to be excluded. *See Sutro Bros. & Co.* v. *Indemnity Insurance Co.,* 264 F.Supp. 273, 289 (S.D.N.Y.), *aff'd,* 386 F.2d 798, 802 (2d Cir. 1967).

The majority concludes that, "[w]here, as here, the obligee is a regulated investment company, rather than a broker, fraudulent purchase of securities for the company by the covered employee at a manipulated price may well be considered outside the contemplated meaning of 'trading.'" *Ante* at 4158. In the early stages of this litigation, however, the district court denied a motion for summary judgment precisely because it believed that "there was a genuine issue as to the meaning of 'trading'

in a brokers' bond when issued to an investment company." At trial, the issue was litigated, and I.N.A. introduced evidence to support the conclusion that in each situation the term "trading" should be given the interpretation offered in the bond itself—"transactions involving the purchase, sale or exchange of securities." No evidence was introduced showing that the term should be interpreted one way for investment companies and another way for brokers. And neither evidence nor argument to that effect is offered here by the majority. In the absence of some persuasive reason to do otherwise, I would conclude that the term has the same meaning regardless of the identity of the plaintiff.

Second, I would not use the Investment Company Act as a device to "bail out" Index Fund from an apparent error in business judgment. Index Fund chose not to purchase a bond that would have covered its loss.[1] The "trading exclusion" of the bond actually purchased by Index contains the proviso that trading losses involving forgery or alteration (Insuring Clause D) and trading losses involving securities forgery (Insuring Clause E) were covered by the bond even though they resulted from trading.[2] The fact that Index Fund declined to purchase

1 The "trading exclusion" in that bond would have read as follows:

> Any loss resulting directly or indirectly from trading, including all transactions involving the purchase, sale or exchange of securities, with or without the knowledge of the Insured, in the name of the Insured or otherwise, whether or not represented by any indebtedness or balance shown to be due the Insured on any customer's account, actual or fictitious, *except when covered under Insuring Clause (A), (D) or (E).*

(emphasis added).

2 The proviso reads as follows:

> If any instrument covered under Insuring Clause (D) or (E) is involved in any trading loss, then this subsection (e) shall not be construed as excluding liability under Insuring Clause (D) or (E)

a bond that also covered trading losses resulting from employee dishonesty (Insuring Clause A)—no doubt because such a bond would cost substantially more than the bond it purchased—leads me to conclude that Index Fund rather than I.N.A. should absorb the loss resulting from Hagopian's activity. Although the majority correctly states that the bond "must be read in conjunction with the statutory requirements pursuant to which it was issued" and that "[c]onsideration must be given to the language of the statute and the purpose for which the bond is given," *ante* at 4158, I fear that today's decision gives undue, in fact, controlling weight to the statute in circumstances involving statutorily required bonds, even to the exclusion of the obvious intent and understanding of the parties to the contract. No court should go that far.

The district court found sufficient evidence to conclude that Index Fund intended to purchase a bond which would conform to § 17(g) of the Act, 15 U.S.C. § 80a-17(g), and the regulation promulgated thereunder, 17 C.F.R. § 270.17g-1. I have no quarrel with this determination. I note also that the Fifth Circuit has made the following suggestion:

> As a general rule, the liability of a surety on a bond which is plain and unambiguous is governed, like any other contract, by the intention of the parties as expressed in the instrument. However, in determining the legal effect of a statutory bond such as is here before the Court, certain rules of construction are to be considered. A statutory bond will be reviewed in the light of the statute creating the duty to give security. It will be *generally* held that the provisions

> on account of such instrument for the amount recoverable thereunder, but in no event for an amount in excess of the amount applicable under this bond for the payment of such loss.

of the statute and regulations will be read into the bond. So also if a statutory bond contains provisions which do not comply with the requirements of law, they may be eliminated as surplusage and denied legal effect.

American Casualty Co. v. *Irvin,* 425 F.2d 647, 650 (5th Cir. 1970) (emphasis added; citations omitted). I doubt that the Fifth Circuit would go as far as today's decision. Here, Index Fund simply failed to meet its obligation under the statute, apparently for purely economic reasons. To read the bond as the majority does is to ignore both the plain language of the bond and the significance of Index Fund's decision to purchase this bond rather than another. Index Fund knew that it was engaged primarily in "trading," and so did the agents who procured this bond on its behalf. The effect of today's decision is to use the statute to give Index Fund precisely that form of additional coverage that it had previously declined to buy. I cannot believe that Congress intended the statute to produce such a result.

I would affirm the decision of the district court and hold Index Fund to its bargain.

Memorandum Decision of Tenney, D. J. Granting INA's Motion for Judgment N.O.V.

UNITED STATES DISTRICT COURT
Southern District of New York

73 Civ. 2386 (CHT)
46461

Index Fund, Inc.,

Plaintiff,

—against—

Insurance Company of North America,

Defendant.

Appearances

For Plaintiff: Charles E. McGuinness, Esq.
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New York, N.Y. 10036

For Defendant: Bigham Englar Jones & Houston
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Of Counsel: William P. Sullivan, Jr., Esq.

Tenney, J.

In this case, Index Fund, Inc. ("Index Fund"), a registered management investment company which operated a mutual fund during the time period with which this action

is concerned, seeks to be reimbursed for certain losses alleged to be within the coverage of an insurance contract, known as a fidelity bond, issued to the plaintiff by the defendant Insurance Company of North America ("INA"). The case was tried to a jury on June 21-23, 1977. On June 23, the jury returned a verdict for the plaintiff in the amount of $98,870. The defendant now moves for judgment in its favor notwithstanding the verdict. For the reasons stated below, the motion is granted.

The evidence presented at trial was brief. Plaintiff put on only one witness, George Frederick Hoffmann, a vice-president and director of Index Fund, who testified to the history of the fund and to certain events in his knowledge and identified a number of documents—corporate documents such as the minute books, communications with the fund's banks relating to the purchase and sale of the securities at issue in this case, and various fidelity bonds issued to the plaintiff by the defendant. After putting into evidence documents relating to the guilty plea of one Robert R. Hagopian, former President of the plaintiff, the plaintiff rested. Taken in the light most favorable to the plaintiff, this evidence showed that Hagopian, while President of Index Fund and thus authorized to buy and sell securities on behalf of Index Fund, entered into a criminal scheme whereby he caused the fund to purchase the securities of eight different companies at artificially inflated prices. Hagopian subsequently pleaded guilty to charges of conspiracy and embezzlement, the latter plea involving a charge of embezzling $98,870 from the plaintiff's accounts on or about August 6, 1970. The plaintiff showed that its loss was occasioned by the eventual sale of the securities which had been purchased at sums of $98,870 to $145,080 but were sold at amounts ranging from $1.00 to $77,563. The totality of such losses was $733,246. It should be noted that the proof showed that 7,000 shares of

Computerized Knitwear, Inc.—which must be the stock referred to but not specifically identified in the indictment—were bought by Index Fund on August 6, 1970 for $98,870 and sold later in the year for a total price of $36,698, leaving a loss on that stock, by the plaintiff's own calculation, of $62,172.

The evidence could also be taken to show, in the light most favorable to the plaintiff, that at all relevant times the plaintiff was covered by one or another in a series of virtually identical fidelity bonds, of a type known as "Brokers' Blanket Bond Form No. 14," issued by the defendant INA.

The relevant portions of Form No. 14 provide:

> "The losses covered by this bond are as follows:
>
> Dishonesty
>
> (A) Loss through any dishonest or fraudulent act of any of the Employees, committed anywhere and whether committed directly or by collusion with others, including loss of Property through any such act of any of the Employees.
>
> . . . .
>
> The foregoing agreement is subject to the following conditions and limitations:
>
> Section 1. This bond does not cover:
>
> . . . .
>
> (c) Any loss resulting directly or indirectly from trading, including all transactions involving the purchase, sale or exchange of securities, with or without the knowledge of the Insured, in the name of the Insured or otherwise, whether or not represented by any indebtedness or balance shown to be due the Insured on any customer's account, actual

> or fictitious, and notwithstanding any act or omission on the part of any Employee in connection with any account relating to such trading, indebtedness, or balance."

The bonds covered losses up to a monetary limit of \$100,000.

The virtual identity of the language of the corporate minutes of the plaintiff with the relevant statutory language appears to indicate that the purchase of these bonds was authorized by the board in order to comply with Section 17(g) of the Investment Company Act of 1940, 15 U.S.C. § 80a-17(g), and the regulation promulgated thereunder, 17 C.F.R. § 270.17g-1, which required that the plaintiff, as an investment company, "be bonded by a reputable fidelity insurance company against larceny and embezzlement" by its officers and employees. The plaintiff introduced no evidence, however, of any communications between the defendant and the plaintiff concerning the purchase of the bonds, nor did it introduce any evidence concerning any communications between the defendant or the plaintiff and any insurance broker through whom the plaintiff purchased the bonds from the defendant.

The defendant, after moving for a directed verdict, called four witnesses, three of whom were employees of INA and one a representative of the Surety Association of America, a trade association representing companies in the fidelity insurance business. The INA employees testified that it was the practice of the defendant to issue a Brokers' Blanket Bond Form No. 14 to investment companies and that the terms of that bond and the meanings of those terms are no different when the bond is purchased by an investment company than when it is purchased by a broker. None of the defendant's witnesses had any personal knowledge of any discussions concerning the issuance of the bonds in

contention in the action, but two testified that it was INA's practice not to provide for losses for "trading" by employees—*i.e.*, that INA routinely provided the type of bond actually purchased by Index Fund—unless "trading" coverage was specifically requested and a supplemental premium paid. The testimony of the trade association representative supported that of the defendant's employees: brokers' blanket bonds are regularly issued to mutual funds as well as to investment banks and stock brokers, and their terms have the same meaning in all three situations.

Discussion

The jury verdict in this case was defective in two regards. First, an award of \$98,870 was clearly against the evidence and was actually impossible under the plaintiff's theory of its loss. Throughout this case, the plaintiff has consistently maintained that the amount of its loss was to be computed as the difference between the inflated prices at which it had been forced to purchase securities through the dishonest acts of Hagopian and the much reduced prices at which it had sold the same securities. The \$98,870 awarded by the jury—a figure identical to that mentioned in that count of the indictment to which Hagopian pleaded guilty[1] as the amount embezzled by Hagopian—cannot possibly reflect the plaintiff's loss, as the plaintiff's own case demonstrates. \$98,870 could only represent the inflated price at which Index Fund was forced to purchase 7,000 shares of Computerized Knitwear, Inc. on August 6, 1970. The plaintiff was later able to sell that same stock, however, for \$36,698, leaving an actual loss to the plaintiff of \$62,172 rather than the \$98,870 found by the jury. While the larger figure may have been sufficient for the purpose of the indictment, it does not represent the amount of a "loss" to the

plaintiff, nor has the plaintiff claimed it as such. Since the fidelity bond covered "losses," the figure of $98,870 as a measure of loss under the bond cannot be allowed to stand.

If this fundamental error by the jury was the only defect in the verdict, the Court would order a new trial unless the plaintiff agreed to a remittitur of that part of the award which did not represent a loss to the plaintiff, *i.e.*, a remittitur of $36,698. *See Neese* v. *Southern Ry.*, 350 U.S. 77 (1955) (per curiam). The Court finds, however, that the verdict was most deeply flawed in that it failed to recognize the dispositive nature of the bond's trading exclusion, a situation which requires this Court to grant judgment notwithstanding the verdict in favor of the defendant.[2]

The standard against which a motion for judgment notwithstanding the verdict must be evaluated is clear: "When the evidence is such that without weighing the credibility of the witnesses there can be but one reasonable conclusion as to the verdict, the court should determine the proceeding . . . by judgment notwithstanding the verdict." *Brady* v. *Southern Ry.*, 320 U.S. 476, 479-80 (1943). Applying that standard here, the Court finds that the only reasonable conclusion from the law and the evidence presented at trial is that the losses occasioned by the dishonest acts of Hagopian[3] are not covered by the fidelity bond since they fit squarely within the bond's trading exclusion, a clause which the Court finds valid and enforceable.

The Court was unable to reach this conclusion upon the previous motions for summary judgment, having then concluded that there was a genuine issue as to the meaning of "trading" in a brokers' bond when issued to an investment company. *Index Fund, Inc.* v. *Insurance Co. of North America*, 73 Civ. 2386 at 15 (CHT), (S.D.N.Y. June 17, 1976).[4] At that time the Court also reserved decision on whether the trading exclusion of the bond should be disregarded as inconsistent with the provisions of 15 U.S.C.

§ 80a-17(g) and of 17 C.F.R. § 270.17g-1 pending the presentation of evidence concerning the circumstances surrounding issuance of the bond. *Id.* at 12-15. With the evidence presented at trial, and with the assistance of the Findings of Fact and Conclusions of Law of District Judge Albert C. Wollenberg for the Northern District of California in a case nearly identical to that under consideration here, *see Research Equity Fund, Inc.* v. *Insurance Co. of North America*, No. C-74-1174 ACW (N.D. Cal. Dec. 16, 1976), the Court now finds that the evidence permits of only one reasonable conclusion: that the loss complained of fell within the trading exclusion of the bond.

Treating separately the issues left for determination at trial, the Court finds first that the evidence, as reviewed above, can be interpreted only as showing that the term "trading" had no different meaning in a Brokers' Blanket Bond Form No. 14 when issued to an investment company than in any other use of the bond. The plaintiff introduced no evidence that "trading" should be given any interpretation other than that contained in the bond itself—"transactions involving the purchase, sale or exchange of securities"—and this Court instructed the jury that the term was to be so defined. The defendant, upon whom fell the burden of proving that the plaintiff's loss fell within the trading exclusion, elicited testimony from several witnesses that the meaning of "trading" in this context was as set forth in the bond. It cannot be disputed that the loss claimed by the plaintiff resulted from the *purchase* of securities at an illegally inflated price and their *sale* at a much lower price.

On the second issue, there was also no evidence at trial that the bond was issued to Index Fund under circumstances which would indicate that the bond's trading exclusion should be disregarded because of any inconsistency with the requirements of 15 U.S.C. § 80a-17(g) and 17

C.F.R. § 270.17g-1. While the plaintiff can be found to have demonstrated that its board wished to obtain a bond which would conform to the requirements of section 80a-17(g), no evidence was introduced to show that the plaintiff communicated to the defendant a desire to obtain a bond without a trading exclusion. Rather, the evidence led in the other direction. The defendant's witnesses testified that the bond was available without the trading exclusion—*i.e.*, with coverage for losses due to trading—and would have been sold that way if requested. The terms of the bond itself make it clear that the bond contains a trading exclusion, and the plaintiff knew or should have known that it had purchased a bond containing such an exclusion. The duty to purchase a bond which would comply with the relevant provisions of the Investment Company Act and the regulation promulgated thereunder fell on the plaintiff and not on the defendant. *See Research Equity Fund, Inc.* v. *Insurance Co. of North America, supra* at 17, ¶¶ 113-14.

Rule 17g-1 begins: "Each registered management investment company shall provide and maintain a bond. . . ." 17 C.F.R. § 270.17g-1. The evidence at trial showed that the plaintiff could have purchased a bond without a trading exclusion at a higher premium but that such a bond was not purchased. Thus, in view of the clear language of the bond and the only reasonable inference from the evidence—that the plaintiff, in fulfilling its statutory duty, could have purchased a bond without a trading exclusion but failed to do so—it is impossible to eliminate the trading exclusion from the bond.

The plaintiff relies in part on a clause in the bond to show that the bond was intended to be in full compliance with the Act and regulations and thus that the trading exclusion should be found to be a nullity. That clause reads:

> "No cancellation, termination or modification of this bond, whether by or at the request of the Insured or by the Underwriter shall take effect prior to the expiration of thirty days after written notice of such cancellation, termination or modification has been filed with the Securities and Exchange Commission, unless an earlier date of such cancellation, termination or modification is approved by said Commission."

This clause cannot be given the meaning argued for by the plaintiff for two reasons. First, to give it such a meaning would be to allow one part of the bond to cancel out another, and contracts should be construed so as to give effect to all of their provisions and not so that one provision will be left without force and effect. *E.g., Addison Terry Co.* v. *N.F.L. Films, Inc.*, 390 F. Supp. 621, 623-24 (S.D.N.Y. 1974). Second, although the evidence showed that copies of the bond had been filed with the SEC, no evidence was produced to show that the SEC found the bond, with its obvious trading exclusion, improper. *Cf. Research Equity Fund, Inc.* v. *Insurance Co. of North America, supra* at 22, ¶¶ 163-64.

The fact remains: the bond contains a trading exclusion and any duty to see that it did not have such an exclusion fell on the plaintiff. Although the plaintiff argued to the Court that "it is common knowledge that insurance policies are contracts of adhesion," Argument on Motion for Directed Verdict, June 22, 1977, at 5, the evidence in this case must be found to disprove this contention, at least with respect to the provision of trading coverage. Such coverage was available, at the option of the investment company. Moreover, the trading exclusion was not a minor detail, forced into the contract by the insurance company or buried in the fine print: the presence or absence of the trading exclusion was a major determinant of the price of the bond. For example, Judge Wollenberg found that the addition of trading coverage in INA's bonds of this type would have

increased the price of those bonds 35-50%. *Research Equity Fund, Inc.* v. *Insurance Co. of North America, supra* at 19, ¶ 140.

The evidence presented at trial, when examined in the light of the Court's findings as to the law, is such that there can be only one reasonable conclusion: the losses suffered by the plaintiff are specifically excluded from coverage by the bond. Accordingly, the Court grants the defendant's motion for judgment notwithstanding the verdict. Furthermore, in fulfillment of Rule 59(c)(1) of the Federal Rules of Civil Procedure, which requires a conditional determination of the motion for a new trial in the event that the judgment is later vacated or reversed, the Court conditionally grants the defendant's motion for a new trial unless the plaintiff accepts a remittitur of $36,698.[3]

So ordered.

Dated: New York, New York
October 17, 1977

Charles H. Tenney
U.S.D.J.

FOOTNOTES

[1] The jury commenced their deliberations at 12:00 noon. At 12:15 they sent a note to the Court requesting that they receive a copy of the indictment to which Hagopian pleaded guilty. Court Exh. 1. No other documents was requested by the jury. After a one-hour luncheon recess, they returned their verdict at 2:14, having deliberated slightly more than one hour.

[2] The Court, when granting a motion for judgment notwithstanding the verdict, is required to rule conditionally on the motion for a new trial in the event that the judgment is later vacated or reversed. Fed. R. Civ. P. 50(c)(1). Thus, a further explanation of the ruling that the defendant is entitled to a new trial unless the plaintiff accepts a remittitur of $36,698 is in order.

The loss with respect to the purchase and sale of the stock of Computerized Knitwear, Inc. was the only concrete loss proved by the plaintiff. While the plaintiff demonstrated, at least to the minimal degree necessary to overcome a motion for judgment n.o.v. on this point, that it had suffered substantial losses on the purchase and sale of seven other securities, no direct evidence was introduced to link those transactions to the dishonest acts of Hagopian. Plaintiff's only witness testified that he had no personal knowledge of Hagopian's acts and that there were no records concerning these transactions in the files of Index Fund. Since the Court denied the plaintiff's request for the issuance of a subpoena compelling Hagopian's presence at the trial on the ground that such a subpoena was beyond the Court's power under Fed. R. Civ. P. 45(e)(1), *Index Fund, Inc.* v. *Insurance Co. of North America*, 73 Civ. 2386 (CHT) (S.D.N.Y. June 7, 1977), and since the plaintiff did not take steps to obtain Hagopian's testimony through depositions pursuant to Fed. R. Civ. P. 32(a)(3)(B), no such testimony was in evidence. Thus, the only evidence that linked Hagopian's misdeeds to a specific loss-creating transaction was his guilty plea to count 19 of the indictment, which must be taken to identify the transaction discussed in the text above. Accordingly, the only loss proved by the plaintiff was the $62,172 from the Computerized Knitwear transaction, and any verdict other than that would have been excessive, speculative and contrary to the evidence.

[3] The jury obviously found that the plaintiff's loss was due in the first instance to Hagopian's dishonest acts, as evidenced by his guilty plea, and that such a loss fell within the general coverage of the bond. The Court agrees that this finding was proper within the limits discussed in note 2 *supra*.

[4] The Court also concluded that there was a genuine issue as to which acts caused the plaintiff's loss. *Id.* at 15-16. This issue was resolved at trial. *See* notes 2-3 *supra*.

[5] *See* note 2 *supra*.

Memorandum-Decision of Tenney, D.J., Denying Summary Judgment Motions.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

73 Civ. 2386 (CHT)

INDEX FUND, INC.,

Plaintiff,

—against—

INSURANCE COMPANY OF NORTH AMERICA,

Defendant.

APPEARANCES

For Plaintiff: CHARLES E. MCGUINNESS, ESQ.
36 West 44th Street
Suite 1115
New York, N.Y. 10036

For Defendant: BIGHAM ENGLAR JONES & HOUSTON
99 John Street
New York, N.Y. 10038
Of Counsel: WILLIAM P. SULLIVAN, JR., ESQ.

TENNEY, J.

This is an action by plaintiff-insured, an investment company, against defendant-insurer on a policy of insurance known as a Brokers Blanket Bond. Plaintiff claims to have sustained a loss covered by the Bond by reason of the dishonest acts of a former employee. The parties have moved and cross-moved for summary judgment.[1]

Plaintiff's amended complaint ("the complaint"), despite the prior ruling of this Court, bases jurisdiction upon the Investment Company Act of 1940, 15 U.S.C. § 80a-43, and the principles of pendent jurisdiction, but unlike the original complaint, the complaint shows that there is diversity jurisdiction.

The complaint alleges that defendant agreed to indemnify and hold plaintiff harmless from loss arising out of the dishonest acts of plaintiff's employees under the terms of insurance contained in defendant's Brokers Blanket Bond, Form No. 14, providing a coverage of $100,000; that Robert R. Hagopian was President and Chairman of the Board of plaintiff and President of Meridian Management Corporation ("Meridian"), plaintiff's investment adviser, in which capacity Hagopian had access to the securities and funds of plaintiff and exercised control over the investment policies of Meridian and plaintiff.

The complaint further alleges, upon information and belief, that John Peter Galanis and Akiyoshi Yamada conspired among themselves and with others to commit a criminal and fraudulent scheme to buy, sell and manipulate the market price of certain securities; that, upon information and belief, Galanis and Yamada paid bribes to Hagopian in excess of $486,000 in money and $54,000 in securities to cause Hagopian to direct mutual funds, including plaintiff's, to buy and sell securities which were being bought, sold and manipulated by Galanis and Yamada; that from on or about June 16, 1970 to on or about August 6, 1970, Hagopian caused plaintiff to purchase securities, which were being bought, sold and manipulated by Galanis and Yamada at an aggregate purchase cost to plaintiff of approximately $1,030,000; that upon information and belief, Galanis, Hagopian and Jerome E. Treisman caused false and misleading reports purporting to be research information concerning securities purchased to be placed in the files of Meridian in order to create the

misleading appearance that said securities transactions had been entered into on the basis of investment value of the securities purchased.

It is further alleged that said securities were subsequently sold by plaintiff at prices which were drastically lower than the prices at which plaintiff had purchased them; that the aggregate price which plaintiff received for the said securities was approximately $300,000; that as the result of the larceny and embezzlement of Hagopian, directly and in collusion with Galanis and Yamada, plaintiff sustained losses in excess of $730,000; that on or about February 21, 1973 plaintiff gave defendant written notice of the discovery of the loss; that on or about March 12, 1973 plaintiff filed an itemized proof of claim of loss, duly sworn to, and demanded payment of the amount of the bond; that plaintiff has performed all of the terms and conditions of the bond on its part to be performed; that defendant has acknowledged receipt of the notice and proof of claim but has failed and refused to indemnify and hold plaintiff harmless from the loss; that plaintiff is entitled to recover from defendant the sum of $100,000.

The complaint further alleges that Hagopian's dishonest and fraudulent acts resulted in his being indicted in the United States District Court for the Southern District of New York (*United States of America* v. *Robert R. Hagopian, et al.*, 72 Crim. 884) and charged with larceny and embezzlement of securities and funds of plaintiff; that, upon information and belief, on January 23, 1973, Hagopian entered a plea of guilty in said criminal proceedings and, on February 28, 1973, was sentenced to serve one year in a federal penitentiary, to pay a fine of $10,000 and to remain on probation for five years following his release from prison.

Defendant's answer to plaintiff's amended complaint consists in part of a general denial of knowledge or information as to whether or not Hagopian was dishonest and

pleads affirmative defenses as follows:

1. That the complaint fails to state a claim upon which relief may be granted.

2. That the bond in suit does not cover loss resulting directly or indirectly from trading and that plaintiff's loss, if any, resulted from trading and is not covered under the bond issued by defendant.

3. That the bond in suit does not cover loss resulting from any violation of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940 or the Investment Advisers Act of 1940 unless it is established that the act or acts which caused the loss involved fraudulent or dishonest conduct which would have caused a loss to the insured in similar amount in the absence of such statutes, rules or regulations; and the plaintiff's loss, if any, resulted from a violation of the Investment Company Act of 1940 or the Investment Advisers Act of 1940 and said loss is not covered under the bond issued by defendant.

The parties do not dispute that there is no triable issue as to the following facts:

1. Defendant-insurer issued to plaintiff-insured a policy of insurance commonly known as a Brokers Blanket Bond, Standard Form 14 (the bond).

2. The bond provided in pertinent part as follows: "The losses covered by this bond are as follows:

DISHONESTY

(A) Loss through any dishonest or fraudulent act of any of the Employees, committed anywhere and whether committed directly or by collusion with others, including loss of Property through any such act of any of the Employees."

3. The bond provided that it did *not* cover: "Any loss resulting directly or indirectly from trading, including all transactions involving the purchase, sale or exchange of securities, with or without the knowledge of the Insured, in the name of the Insured or otherwise, whether or not represented by any indebtedness or balance shown to be due the Insured on any customer's account, actual or fictitious, and notwithstanding any act or omission on the part of any Employee in connection with any account relating to such trading, indebtedness, or balance."

4. The said bond provided that it did *not* cover: "Any loss resulting from any violation by the Insured, or by any Employee, Partner or Director of the Insured, of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, the Investment Advisers Act of 1940, as heretofore or hereinafter amended, or any other federal, state or municipal statute regulating securities transactions or any rule or regulation made pursuant to any of the said statutes unless it is established by the Insured that the act or acts which caused the said loss involved fraudulent or dishonest conduct which would have caused a loss to the Insured in similar amount in the absence of such statutes, rules or regulations."

5. By payment of an additional premium plaintiff could have obtained coverage for trading losses which were occasioned by dishonest acts of employees.

6. Plaintiff did not avail itself of the available coverage for trading losses occasioned by employee dishonesty.

With respect to plaintiff's motion for summary judgment, it appears from the pleadings and papers submitted that there is no agreement by the parties as to the acts allegedly committed by Hagopian and others giving rise to the loss by plaintiff. Plaintiff, in its motion for summary judgment, has attempted to incorporate by reference the "Official Proceedings in S.E.C. v. Everest Management Corporation, et al., U.S.D.C., S.D.N.Y. Docket No. 71 Civ. 4392" and the "Official Proceedings in U.S.A. v. Robert R. Hagopian, et al., U.S.D.C, S.D.N.Y. Docket No. 72 Crim. 884." Defendant was not a party to such proceedings and may not be bound by such hearsay. Plaintiff in support of the allegations of the amended complaint also incorporates by reference affidavits by George F. Hoffman, a vice president of plantiff and Charles E. McGuinness, Esq., plaintiff's attorney, neither of whom had personal knowledge of the allegedly dishonest acts of Hagopian. Furthermore, Mr. McGuinness' affidavit is replete with allegations of dishonesty by persons, *i.e.*, Gal nis and Yamada, who were not employed by plaintiff and whose acts were not covered by defendant's bond. Such affidavits clearly do not comply with Rule 56(e) and summary judgment may not be granted to plaintiff. Furthermore, it appears that defendant genuinely lacks knowledge of whether plaintiff's employee, Hagopian, caused the particular purchase in question to be made by plaintiff and if he did, whether his actions constituted dishonesty.

Defendant, for the sole purpose of its motion for summary judgment, assumes the allegations of the amended complaint to be true.

The affidavit of John M. Killeen in support of defendant's motion states that he is manager of defendant's bond claim department and has been in charge of the plaintiff's claim from its inception; that plaintiff claims to have sustained a loss within the coverage of a Brokers Blanket Bond issued by I.N.A. to plaintiff; that the bond covers loss through dishonest or fraudulent acts of plain-

tiff's employees; that the bond does not cover any loss resulting directly or indirectly from trading notwithstanding any act or omission on the part of any employee in connection with any account relating to such trading indebtedness or balance.

Killeen's affidavit further states that on or about February 21, 1973, I.N.A. received a letter from plaintiff's counsel claiming that plaintiff had sustained a loss in excess of $500,000 through the fraudulent and dishonest acts of Robert R. Hagopian, former president of the plaintiff; that on or about March 12, 1973 plaintiff filed an "Itemized Proof of Claim of Loss"; that the "Proof of Loss" clearly shows that the claimed loss resulted from transactions involving the purchase, sale or exchange of securities; that essentially plaintiff claims that on and between June 16, 1970 and August 6, 1970 plaintiff made eight purchases of securities for sums totalling $1,034,840 and that said securities were subsequently sold for $301,594 and thus plaintiff suffered a loss in the sum of $733,000; that on May 8, 1973 Killeen wrote plaintiff denying liability; that whether or not Hagopian acted dishonestly in causing the purchase and/or sale of the securities, the loss resulting therefrom is not covered under the Bond because it falls within the "trading exclusion".

Killeen concludes his affidavit by stating that coverage for loss from trading was available to plaintiff but that plaintiff did not avail itself of the coverage.

The transactions reflected by the Itemized Proof of Claim or Loss are as follows:

Security	No. Units	Trade Date	Purchase Price
Health Evaluations, Inc., Common Stock	9,000 shs.	6/16/70	$ 145,080
Devon International, Ltd., Common Stock	15,000 shs.	6/16/70	136,275
Regency for Men, Ltd. Common Stock	35,000 shs.	6/16/70	142,100

Security	No. Units	Trade Date	Purchase Price
Nationwide Marketing Assc., Common Stock	35,000 shs.	6/16/70	142,100
Hair Extension Center, Inc., Warrants	20,000 wts.	6/17/70	121,460
Haywood Mf'g Inc. Common Stock	15,000 shs.	7/ 7/70	128,955
Summit Group Common St. & Warrants	4,800 units	7/23/70	120,000
Computerized Knitwear, Inc., Common Stock	7,000 shs.	8/ 6/70	98,870
			$1,034,840

The securities were thereafter sold at prices as follows:

Security	Date(s) of Sale	Proceeds
Health Evaluation Systems, Inc.	December 13, 1972	$ 1.00
Devon International Ltd.	September 23-October 12, 1970	33,098.00
Regency for Men, Ltd.	April 7, 1971	74,175.00
Nationwide Marketing Associates, Inc.	September 17, 1970	30,231.00
Hair Extension Center, Inc.	December 13, 1972	1.00
Haywood Manufacturing Co., Inc.	September 24-November 13, 1970	49,827.00
Summit Group, Inc.	September 28-November 30, 1970	77,563.00
Computerized Knitwear, Inc.	August 31-December 11, 1970	36,698.00
		$301,594.00

(See Defendant's Memo. in Support of Motion at 11-12).

Thus, plaintiff claims, it purchased the securities for the total sum of $1,034,840, sold them for $301,594, and thereby sustained a loss of $733,246.

It seems arguable that at least under New York law and in a diversity case these transactions constituted "trading" within the meaning of the exclusionary clause of the bond—Section 1(e)(1) (Exhibit A attached to defendant's motion papers herein). *Condon* v. *National Surety Corp.*, 22 App. Div. 2d 305, 254 N.Y.S.2d 620 (1st Dep't 1964), *aff'd on opinion below,* 16 N.Y.2d 775, 209 N.E.2d 819, 262 N.Y.S.2d 499 (1965); *Kean* v. *Maryland Casualty Company,* 221 App. Div. 184, 223 N.Y.S. 373 (1st Dep't 1927), *aff'd without opinion,* 248 N.Y. 534, 162 N.E. 514 (1928); *Sutro Bros. & Co.* v. *Indemnity Insurance Company of North America,* 264 F. Supp. 273 (S.D.N.Y.), *aff'd* 386 F.2d 798 (2d Cir. 1967).

In this context, reconsideration of the applicable law, state or federal, becomes important. Plaintiff still predicates jurisdiction upon Section 44 of the Investment Company Act of 1940, 15 U.S.C. § 80a-43, which reads in pertinent part as follows:

> "The district courts of the United States . . . shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and . . . of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter or the rules, regulations, or orders thereunder. . . ."

In its earlier memorandum of January 15, 1975, this Court, citing and quoting from *First National Bank* v. *Williams,* 252 U.S. 504, 512 (1920) stated as follows:

> "Plaintiff must demonstrate that its cause of action 'arises under' a law of the United States and in the

opinion of this Court that showing has not been made.

"It appears to the Court that the claim stated by the plaintiff arises out of the contract between plaintiff and defendant and the interpretation thereof. As such it would be governed by state law. There is no allegation that any violation of the 'subchapter or the rules, regulations, or orders thereunder,' has occurred. To the contrary, there seems to have been compliance with the subchapter as manifested by the securing of the bond in question, and plaintiff so states. Further, plaintiff does not seek to 'enforce any liability or duty created by' the subchapter. All duties enumerated under this subchapter fall upon the plaintiff. Therefore, any liability would necessarily arise as a result of the breach of one or more of those duties and that liability would fall on plaintiff. Any liability which could be ascribed to the defendant herein would necessarily arise out of the contract of insurance and would be governed by state law. Finally, plaintiff clearly does not seek to 'enjoin any violation of' this subchapter. Indeed, the only relief sought by plaintiff is money damages." (Memorandum Opinion of January 15, 1975, at 3-4).

The Court, on reconsideration of its prior decision, now believes that federal, rather than state, law is applicable since the suit involves an insurance contract mandated by federal law, *Hartford Accident and Indemnity Company* v. *Baldwin,* 262 F.2d 202 (8th Cir. 1958), and the rights of the parties must be determined under federal law rather than state law. *Liebman* v. *United States,* 153 F.2d 350 (9th Cir. 1946).

Under the provisions of 15 U.S.C. § 80a-17(g) of the Investment Company Act,

"[t]he Commission is authorized to require by rules and regulations or orders for the protection of in-

vestors that any officer or employee of a registered management investment company who may singly, or jointly with others, have access to securities or funds of any registered company, either directly or through authority to draw upon such funds or to direct generally the disposition of such securities (unless the officer or employee has such access solely through his position as an officer or employee of a bank) be bonded by a reputable fidelity insurance company against larceny and embezzlement in such reasonable minimum amounts as the Commission may prescribe."

Rule 17g-1 promulgated thereunder (17 C.F.R. § 270.17g-1) reads in pertinent part as follows:

"§ 270.17g-1 Bonding of officers and employees of registered management investment companies.

(a) Each registered management investment company shall provide and maintain a bond which shall be issued by a reputable fidelity insurance company, authorized to do business in the place where the bond is issued, against larceny and embezzlement, covering each officer and employee of the investment company, who may singly, or jointly with others, have access to securities or funds of the investment company, either directly or through authority to draw upon such funds or to direct generally the disposition of such securities, unless the officer or employee has such access solely through his position as an officer or employee of a bank (hereinafter referred to as 'covered persons').

* * * *

(d) The bond shall be in such reasonable form and amount as a majority of the board of directors of the registered management investment company who are not 'interested persons' of such investment company

as defined by section 2(a)(19) of the Act shall approve as often as their fiduciary duties require, but not less than once every twelve months, with due consideration to all relevant factors including, but not limited to, the value of the aggregate assets of the registered management investment company to which any covered person may have access, the type and terms of the arrangements made for the custody and safekeeping of such assets, and the nature of the securities in the company's portfolio: *Provided, however,* That (1) the amount of a single insured bond shall be at least equal to an amount computed in accordance with the following schedule:"

The schedule that follows contains two parallel columns, one listing the value of the gross assets of the investment company at the end of the most recent fiscal quarter and the other column listing the minimum amount of bond applicable to the particular asset valuation.

Accordingly, it would appear to be the duty of plaintiff through its directors to provide and maintain a bond against larceny and embezzlement. In order to determine the meaning of larceny and embezzlement within the meaning the Investment Company Act, it seems logical to refer to 15 U.S.C. § 80a-36 which reads as follows:

"§ 80a-36. Larceny and embezzlement

Whoever steals, unlawfully abstracts, unlawfully and willfully converts to his own use or to the use of another, or embezzles any of the moneys, funds, securities, credits, property, or assets of any registered investment company shall be deemed guilty of a crime, and upon conviction thereof shall be subject to the penalties provided in section 80a-48 of this title. A judgment of conviction or acquittal on the merits under the laws of any State shall be a bar to any prosecution under this section for the same act or acts."

It seems clear that violation of the above section, if committed by an employee of the insured, would fall within Clause A of the bond, except for the exclusionary provisions of Section 1(e)(1), and Hagopian was convicted of a violation of the above-quoted penal statute. It also seems clear that such violation would fall within Clause A under the provisions of Section 1(e)(2), which coverage could have been obtained by payment of an additional premium. (Exhibit A attached to defendant's moving papers herein).

It is plaintiff's contention that plaintiff was contracting for fidelity bond coverage that would satisfy plaintiff's obligation and the requirements of the Investment Company Act, as witnessed by the so-called "S.E.C. Cancellation Clause," and that the form of bond, a Brokers Blanket Bond, Form 14, was selected by defendant and its agents and not by plaintiff.

Plaintiff also contends that the provisions of a statute pursuant to which a bond is given are to be read into the bond and considered a part of it, and conditions in the bond repugnant thereto are to be treated as mere surplusage. *United States* v. *Hartford Accident & Indemnity Co.*, 117 F.2d 503 (2d Cir. 1941); *American Casualty Company of Reading, Pennsylvania* v. *Irvin*, 426 F.2d 647, 650 (5th Cir. 1970).

Furthermore, plaintiff claims that the authorities cited by defendant related to "trading" by stock brokers and dealers and not by investment companies and are inapposite, and that the loss was not incurred in the instant suit by "trading" but from the fraudulent advice and criminal activities of Hagopian.

It seems clear, therefore, that material factual issues exist as to the meaning of "trading" in a *brokers* bond when issued to an investment company, as to the circumstances surrounding the issuance of the bond, and as to the

causative acts which occasioned the loss to plaintiff. Under the law in this Circuit summary judgment for defendant must likewise be denied. *Home Insurance Co.* v. *Aetna Casualty & Surety Co.,* 528 F.2d 1388 (2d Cir. 1976); *National Life Ins. Co.* v. *Solomon,* 529 F.2d 59, 61 (2d Cir. 1975); *Heyman* v. *Commerce and Industry Insurance Company,* 524 F.2d 1317 (2d Cir. 1975); *Filor, Bullard & Smyth* v. *Insurance Company of North America,* 74 Civ. 2597 (S.D.N.Y., February 19, 1976, Pierce, *J.*). *Compare Bass* v. *American Insurance Company,* 493 F.2d 590 (9th Cir. 1974).

Accordingly, both the motion and cross-motion for summary judgment are denied.

So ordered.

Dated: New York, New York
June 17, 1976

CHARLES TENNEY,
U.S.D.J.

FOOTNOTE

[1] This is not the first occasion that such motions have been interposed in this action. In September 1974 plaintiff moved for summary judgment and defendant cross-moved for summary judgment on the grounds that the loss sustained by plaintiff came within the "trading exclusion" of the policy, and further, defendant moved to dismiss plaintiff's complaint on the ground that the Court did not have jurisdiction under the Investment Company Act of 1940, 15 U.S.C. § 80a-43, and that diversity was not pleaded in the complaint. On January 15, 1975 this Court dismissed the complaint for failure to demonstrate that its cause of action arises under a law of the United States, *i.e.,* the Investment Company Act of 1940. Plaintiff, upon leave of the Court, timely served an amended complaint alleging diversity but also repeating the alleged jurisdictional grounds based on the Investment Company Act. Defendant has duly served and filed its answer to the amended complaint.

Judgment of the Court of Appeals.

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the first day of August one thousand nine hundred and seventy-eight.

Present: HON. IRVING R. KAUFMAN
Chief Judge
HON. J. JOSEPH SMITH
HON. THOMAS J. MESKILL
Circuit Judges,

77-7600

INDEX FUND, INC.,
Plaintiff-Appellant,
v.
INSURANCE COMPANY OF NORTH AMERICA,
Defendant-Appellee.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

Judgment of the Court of Appeals.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the judgment notwithstanding the verdict of said District Court be and it hereby is reversed and the order granting a new trial be and it hereby is affirmed and the case be and it hereby is remanded in accordance with the opinion of this court, with costs to be taxed against the defendant-appellee.

A. Daniel Fusaro,
Clerk

By Sara Piovia
Deputy Clerk

Order Denying Petition for Rehearing.

UNITED STATES COURT OF APPEALS
Second Circuit

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the fourteenth day of September, one thousand nine hundred and seventy-eight.

Present:

Hon. Irving R. Kaufman
Hon. J. Joseph Smith
Hon. Thomas J. Meskill
Circuit Judges.

77-7600

Index Fund, Incorporated
Plaintiff-Appellant

v.

Insurance Company of North America
Defendant-Appellee

A petition for a rehearing having been filed herein by counsel for the defendant-appellee

Upon consideration thereof, it is

Ordered that said petition be and it hereby is Denied.

A Daniel Fusaro
A. Daniel Fusaro
Clerk

By Carolyn Clark Campbell
Deputy Clerk

Order Denying Petition for Rehearing En Banc.

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a stated term of the United States Courtof Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the fourteenth day of September, one thousand nine hundred and seventy-eight.

77-7600

Index Fund, Inc.

Plaintiff-Appellant

v.

Insurance Company of North America

Defendant-Appellee

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the defendant-appellee, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is DENIED.

IRVING R. KAUFMAN
IRVING R. KAUFMAN
Chief Judge

Conclusions of Law of Wollenberg, D.J.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

No. C-74-1174 ACW

RESEARCH EQUITY FUND, INC.,

Plaintiff,

vs.

THE INSURANCE COMPANY OF NORTH AMERICA,

Defendant.

No. C-73-2178 ACW

PERFORMANCE PLUS FUND, LTD.,

Plaintiff,

vs.

WINFIELD & CO., INC., et al.,

Defendants and
Third-Party Plaintiffs,

vs.

MARK F. HOPKINS & CO., INSURANCE BROKERS, INC.,
a corporation, et al.,

Third-Party Defendants.

CONCLUSIONS OF LAW

1. The Court has jurisdiction in action C-74-1174 under 28 U.S.C. § 1332 and venue is properly laid in this District

under 28 U.S.C. §§ 1391(a), (c). Said action is a proper action for declaratory relief under 28 U.S.C. § 2201 in that an actual controversy exists between Winfield Growth Fund and defendant Insurance Company of North America involving their respective rights and liabilities under the Winfield Bonds.

2. The Court has jurisdiction over Performance Plus Fund's action against defendant Insurance Company of North America in action C-73-2178 under 28 U.S.C. § 1332. Venue is properly laid in this District under 28 U.S.C. §§ 1391(a), (c). The Court has jurisdiction of the cross-claims of Winfield & Co., Inc. and Winfield Associates, Inc. against Insurance Company of North America in action C-73-2178 because of jurisdiction over the primary claims against the cross-claimants and Rule 13(g), Federal Rules of Civil Procedure.

3. A. Stephen Sanders was an officer and employee of Winfield & Co., Inc. and Winfield Associates, Inc.

4. Under California law, for purposes of determining liability for tortious actions, an individual may be considered an employee of both a special and general employer. *Strait* v. *Hale Construction Co.*, 26 Cal.App. 3d 941, 103 Cal. Rptr. 487 (1972). The public policy considerations underlying the determination of the proper allocation of risk that lie behind this conclusion include the ability of a special employer to insure against the risks involved in the particular activity that gave rise to the claim for liability. Despite the parties' attempt to fit this case into the conceptual framework of the general-special employer problem, such an approach is not appropriate. While under that approach, it may be concluded that Sanders was also an employee of Winfield Growth Fund in that the Fund

could properly be held accountable to anticipate the need to obtain insurance covering the actions of Sanders pertinent to this case, such a determination begs the question of whether the Fund in fact did obtain such insurance coverage.

5. Considering all the circumstances of this case, including the definition of "employee" in the bonds, the Fund's representations to the S.E.C., and the Fund's representations to INA, A. Stephen Sanders was not an officer or employee of the Winfield Growth Fund for the purposes of coverage under the Winfield Bonds.

6. Sanders was not an officer or employee of the Performance Plus Fund.

7. Robert Hagopian was an employee of Meridian Management Corporation.

8. The trading loss exclusion contained in INA's bonds limits fidelity coverage under Insuring Clause A.

9. The meanings of "trading" and the trading loss exclusion in the bonds are not ambiguous and uncertain.

10. The losses claimed or anticipated by Winfield Growth Fund, Performance Plus Fund, Winfield & Co., Inc., and Winfield Associates, Inc. arising from the activities of Sanders and Hagopian pertinent to these lawsuits arose, directly or indirectly, from trading within the terms of the trading loss exclusion clause of the bonds.

11. Mark Hopkins, Inc. under the facts of this case was acting as a broker on behalf of the Winfield entities and not as an agent for INA.

12. The trading loss exclusion does not render INA's bonds illusory to the Winfield entities and the Meridian entities named as insureds on the bonds.

13. The insureds had no reasonable expectation that the losses of the character sustained by them in this case would be covered under INA's bonds.

14. With respect to the Winfield Bonds, it was reasonable for Winfield Growth Fund to expect that the bonds satisfied the requirements of S.E.C. Rule 17g-1.

15. With respect to Winfield Growth Fund, the Winfield Bonds were statutory bonds as required by Rule 17g-1.

16. No other insured on any of the bonds had a reasonable expectation that the bonds satisfied any requirement under Rule 17g-1 and none of the bonds are statutory bonds for any of the insureds other than Winfield Growth Fund.

17. Rule 17g-1, 17 C.F.R. § 270.17g-1, requiring registered management investment companies to maintain fidelity bonds was enacted pursuant to Section 17(g) of the Investment Company Act of 1940, 15 U.S.C. § 80a-17(g), which authorized such a rule to cover employees of registered management investment companies. Congress was aware of the differences and interrelationships between management investment companies and investment advisers. It also authorized the S.E.C., under the Investment Company Act of 1940, to adopt rules to prevent fraudulent, deceptive, or manipulative practices on the part of certain persons connected with investment advisers, 15 U.S.C. § 80a-17(j). Section 17(g) of the Act, however, does not mention investment advisers.

Paragraph (b) of Rule 17g-1 provides that three types of bonds satisfy the Rule. One type, a "joint insured bond", can include "persons engaged in the management" of a registered management investment company as insureds on the bond. These persons would include investment advisers who have management contracts with a registered management investment company. They are not "covered persons" within the terms of paragraph (a) of Rule 17g-1. Coverage of these persons is optional, and lack of such coverage does not affect the adequacy of the bond for purposes of Rule 17g-1. "The use of joint insured bonds by investment companies is permissive rather than mandatory." 39 Federal Register 10578 (March 21, 1974).

Consequently, employees of investment advisers who render services to registered management investment companies are not "employees" or "covered persons" within the meaning of Rule 17g-1(a).

18. As statutory bonds with respect to Winfield Growth Fund, the Winfield Bonds have to be interpreted in light of Rule 17g-1. Even assuming, however, that Rule 17g-1 would consider Sanders to be an "employee" of Winfield Growth Fund and a "covered person", and assuming further that the losses claimed by Winfield Growth Fund come under the terms "larceny and embezzlement", the bonds cannot be read as providing the coverage claimed by Winfield Growth Fund. Despite the statutory bond situation, considering Sanders to be an employee of Winfield Growth Fund and considering the trading loss "exclusion to be inapplicable to the claimed losses would be "necessarily and absolutely inconsistent with the unequivocal intent of the parties as disclosed by the express terms of the bond itself." *Milliron* v. *Dittman,* 180 Cal. 443, 446 (1919).

19. These bonds are not adhesion contracts.

Conclusions of Law of Wollenberg, D.J.

20. The bonds are for the benefit of the named insureds only and are not for the benefit of third parties.

21. Exclusion 1(h) does not apply in these cases.

22. Any conclusion of law herein properly deemed a finding of fact shall be considered a finding of fact.

23. Defendant INA is entitled to dismissal of the eleventh and twelfth claims for relief in the complaint of Performance Plus Fund in C-73-2178.

24. The cross-claims of Winfield Associates, Inc. and Winfield & Co., Inc. in C-73-2178 against INA should be dismissed.

25. INA is entitled to judgment against Research Equity Fund dismissing action C-74-1174 with prejudice and with costs.

DATED: December 16th, 1976.

ALBERT C. WOLLENBERG
ALBERT C. WOLLENBERG
United States District Judge

Statutory Provisions.

The Investment Company Act of 1940, 15 U.S.C. § 80a-1, *et seq.,* is involved in this case. The pertinent provisions of the statute are:

Section 17(g):

"The Commission is authorized to require by rules and regulations or orders for the protection of investors that any officer or employee of a registered management investment company who may singly, or jointly with others, have access to securities or funds of any registered company, either directly or through authority to draw upon such funds or to direct generally the disposition of such securities (unless the officer or employee has such access solely through his position as an officer or employee of a bank), be bonded by a reputable fidelity insurance company against larceny and embezzlement in such reasonable minimum amounts as the Commission may prescribe." 15 U.S.C. § 80a-17(g).

The Securities and Exchange Commission thereafter promulgated Rule 17g-1, which reads, in pertinent part, as follows:

"(a) Each registered management investment company shall provide and maintain a bond which shall be issued by a reputable fidelity insurance company, authorized to do business in the place where the bond is issued, against larceny and embezzlement, covering each officer and employee of the investment company, who may singly, or jointly with others, have access to securities or funds of the investment company, either directly or through authority to draw upon such funds or to direct generally the disposition of such securities, unless the officer or employee has such access solely

through his position as an officer or employee of a bank (herinafter referred to as 'covered persons')." 17 C.F.R. § 270.17g-1

Section 37 of the Investment Company Act of 1940 provides:

"Whoever steals, unlawfully abstracts, unlawfully and willfully converts to his own use or to the use of another, or embezzles any of the moneys, funds, securities, credits, property, or assets of any registered investment company shall be deemed guilty of a crime, and upon conviction thereof shall be subject to the penalties provided in section 49. A judgment of conviction or acquittal on the merits under the laws of any State shall be a bar to any prosecution under this section for the same act or acts." 15 U.S.C. § 80a-36.

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1978

No. 78-923

INSURANCE COMPANY OF NORTH AMERICA,

Petitioner,

v.

INDEX FUND, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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RESPONDENT'S BRIEF IN OPPOSITION

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Opinions Below

The opinion of the Court of Appeals (Pet. App. A1 - A16) is reported at 580 F. 2d 1158. The opinion of the District Court (Pet. App. A17 - A28) is not reported.

Question Presented

Is the bond which respondent was required to procure under Section 17(g) of the Investment Company Act of 1940 (15 U.S.C. 80a-17(g), the "Act") a statutory bond which Congress intended cover losses arising from the kind of dishonest and fraudulent activity in which respondent's president engaged ?

Statement

Respondent is a registered investment company and procured a fidelity bond from petitioner pursuant to the requirements of Section 17(g) of the Act and Rule 17g-1 promulgated by the Securities and Exchange Commission (the "Commission") under the Act.

Respondent sued on the bond to recover losses resulting from the dishonest and fraudulent activity of its former president, Robert R. Hagopian. At the trial in the District Court respondent proved that Hagopian had engaged in a scheme whereby he caused respondent to purchase securities at artificially inflated prices. Respondent also proved that Hagopian was convicted on charges of conspiracy and embezzlement under Section 37 of the Act. (Pet. App. A18).

The Court of Appeals reversed the judgment n.o.v. entered by the District Court ruling that the bond in suit was a "statutory bond" which the Congress intended cover the kind of dishonest and fraudulent activity engaged in by Hagopian.

The Court of Appeals therefore awarded judgment to the respondent. (Pet. App. at A9, 580 F. 2d at 1163).

The Commission has concurred. <u>Investment Company Act Release No. 10393</u>, September 8, 1978.

Argument

1. The Court of Appeals correctly found that the bond is a "statutory bond" which is to be read in conjunction "..with the language of the statute and the purpose for which the bond is given. <u>American Casualty Co. of Reading, Penn. v. Irwin</u>, 426 F. 2d 647 (5th Cir. 1970)" (Pet. App. at A8, 580 F. 2d at 1162).

Thus, it follows, that petitioner's argument that there was a choice of coverages available to respondent is illusory because the statute permits of no such choices. For like reason, the additional argument that the Court of Appeals ignored the intentions of the parties to the insurance contract is irrelevant, as the only concern in this case must be with the coverage of a bond required by an Act of Congress.

2. Rule 19 of the Revised Rules of the Court states the considerations governing review on certiorari. The instant petition fails to disclose any special or important reason for granting the writ.

A. There is no conflict with the decision of another court of appeals.

The Ninth Circuit appeal to which

petitioner refers, Research Equity Fund v. The Insurance Company of North America, C-74-1174, has not yet been decided by the Ninth Circuit Court of Appeals. Furthermore the case in the Ninth Circuit is quite distinguishable. Among the more important differences is the lack of a criminal conviction for conspiracy and embezzlement by the dishonest investment advisor. More importantly, perhaps, is the finding that such person was not an employee covered by the bond sued upon.

B. There has not been a decision of an important state question in conflict with applicable state law.

The New York cases cited by petitioner (Kean v. Maryland Casualty, 248 N.Y. 534 (1928) and Condon v. National Surety Corp., 16 N.Y. 2d 775 (1965) did not deal with the coverage to be afforded by a statutory bond; rather, they were concerned with the meaning of the word "trading". In both cases, the losses sued upon arose from securities transactions with customers of brokerage houses. The brokers argued that the trading loss exclusion in the bonds was not intended to apply to brokerage transactions. The distinction sought to be made between "dealer" transactions and "broker" transactions was not recognized in the lower New York courts. In affirming, the New York Court of Appeals rendered no opinions.

3. The decision of the Court of Appeals for the Second Circuit is consistent with the objectives of the Congress that enacted the legislation, which were "...to mitigate and, in so far as feasible

to eliminate conditions described as not in the best interests of the security holders of investment companies" Hearings on S. 3580 before a Subcommittee of the Senate Committee on Banking and Currency, 76th Cong., 3d Sess. at 37, see also 264-5 (1940). cf. American Power & Light Co. v. Securities and Exchange Commission, 329 U.S. 90 at 105, 113 (1946).

The decision of the Court of Appeals is also consistent with prior decisions with which this Court appears to have agreed on similar questions arising under the federal securities laws. Securities and Exchange Commission v. Talley Industries, Inc., 399 F. 2d 396 (2d Cir. 1968) cert. denied 393 U. S. 1015(1969); U.S. v. Deutsch, 451 F. 2d 98 (2d Cir. 1971) cert. denied 404 U.S. 1019 (1972); U.S. v. Blitz, 533 F. 2d 1329 (2d Cir. 1976) cert. denied 429 U.S. 819 (1976).

Conclusion

The petition for a writ of certiorari should be denied.

Dated: New York, New York
January 24, 1979

Respectfully submitted,

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Counsel for Respondent